

# DOW THEORY LETTERS INC.

SAVE

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Letter 452

**THE MARKET:** For four years I have been warning subscribers that a primary bear market is in force. During the initial February to October, 1966 decline, my warnings seemed to make sense to readers, since it takes little imagination to "believe" in a bear market when stocks are falling.

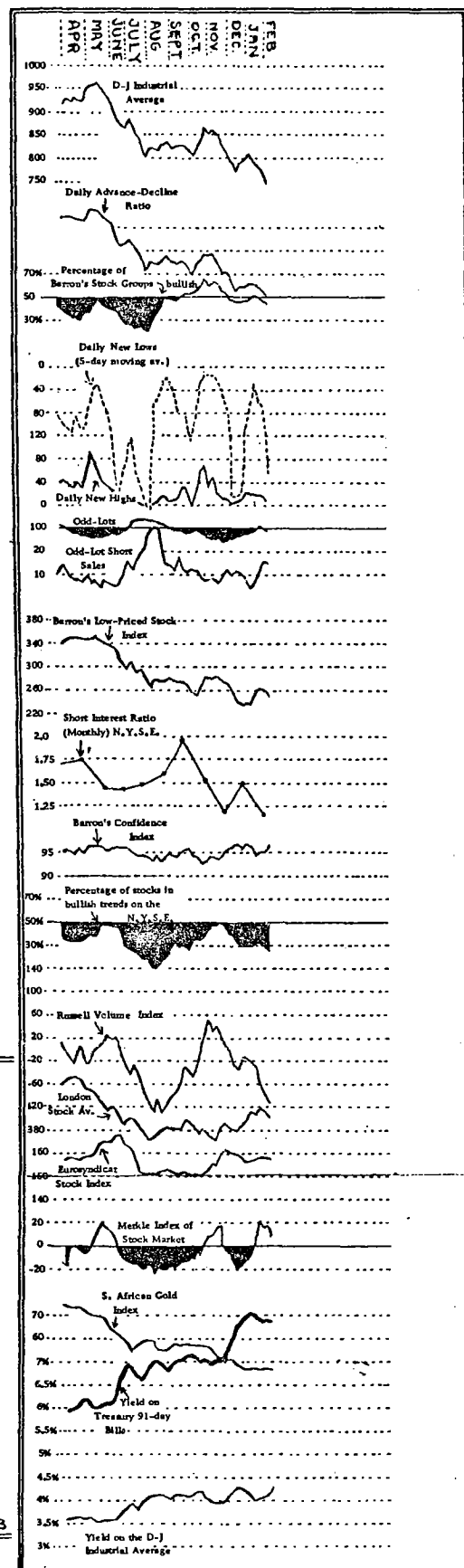
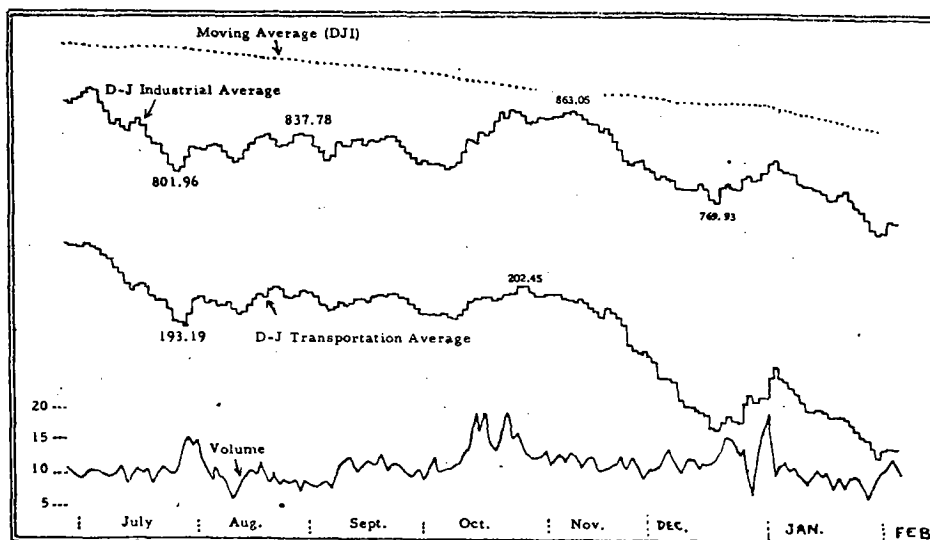
From the October, 1966 low, the market turned up, entering into an extended and speculative upward correction. The upward move ended in December, 1968. All during that time I continued warning subscribers that the market was living on borrowed time. I stated repeatedly that when the primary force is "held back," the ultimate resumption of the primary trend is that much more vicious and persistent.

Now obviously, it is a good deal more difficult to believe in a continuing primary bear market when an upward correction is taking place, particularly an extended and exciting upward move. Nevertheless, I am pleased to say that the great majority of my subscribers heeded my repeated warnings. I can tell this is true from many letters received here and from the fact that last month was the biggest new and renewal subscription month for Dow Theory Letters since this service began publication.

In December, 1968, following one of the greatest upward corrections in Wall Street history, the forces of the bear took hold again. The market moved lower all through 1969, and the Industrial Average gave up 166.89 points for the year. The Dow Industrials stood at 800.96 on December 31, 1969. In comparison, so far in 1970 the Industrials have lost 58 points,

On January 30, thirty-nine months after the October, 1966 low, the Dow Industrials finally penetrated the 1966 low of 744.32. Thirty-nine months is an incredibly long time for the primary (bear) forces to be held back. It is entirely possible (as I have often stated) that the bear market will now make up for lost time.

For example, it would not be at all surprising if the Industrial Average lost as much or more in 1970 (now that the 1966 low has been penetrated) as it did in



Page 2 1969. If 1970 was simply to equal 1969 in terms of Dow points erased, the Industrials could touch the 635 level. If for the sake of argument, 1970 is fated to be twice as bad as 1969 the Dow could smash to the 465 area.

I don't pretend to have a crystal ball. I simply work with my knowledge of bull and bear markets and the implications of the price movement (augmented as much as possible with my studies of various technical indicators). However, I will state that there is a good possibility that the Dow could do as badly during 1970 as it did during 1969. Moreover, (1) because the primary bear forces have been held back for thirty-nine months, (2) because we are now further along in the bear market, and (3) because all previous bear market lows have now been penetrated, I would say that the odds actually favor 1970 being a worse year than 1969. In saying this, I do not believe I am applying prejudice; I believe I am merely applying logic.

**SHORT TERM:** Market analysis is at best an art; I have never seen it reduced to any sort of exact, successful science. Part of the art is in knowing or sensing where to look and then making something out of what one sees.

Out of dozens of various economic and market indicators which I follow, two stand out, and they stand out because they are saying something far out of the ordinary. The first is Barron's Confidence Index. I read this Index in reverse now. At 97.1 the C.I. is saying that bond investors are now confident since they are paying almost as much for yields on the medium quality D-J 40-Bond Index as they are for the yields on Barron's 10-Highest Grade Bonds. The C.I. is simply the ratio of the yields on these two indices. That ratio at 97.1 is very high, and it shows that confidence in the bond market's safety is very high. I believe that confidence is ridiculously misplaced.

According to editor Donald Story in the latest (February) Bank Credit Analyst, ".....the Federal Reserve in 1967 and 1968 demonstrated its inability to improve liquidity in the economy. The huge expansion in its own paper assets not only failed to improve corporate and bank liquidity, but fostered an acceleration of gold losses, in the rate of inflation, the rate of interest, the rate of debt creation, and hence the reduction of liquidity to even lower levels than in 1966. In other words, we are back to 1966, but with a much more over-extended and vulnerable financial structure." In view of what Story's charts show, I must conclude that the high level of the Confidence Index is ominous. It merely shows me that the bond market is not ready for what may be coming up—a liquidity crisis.

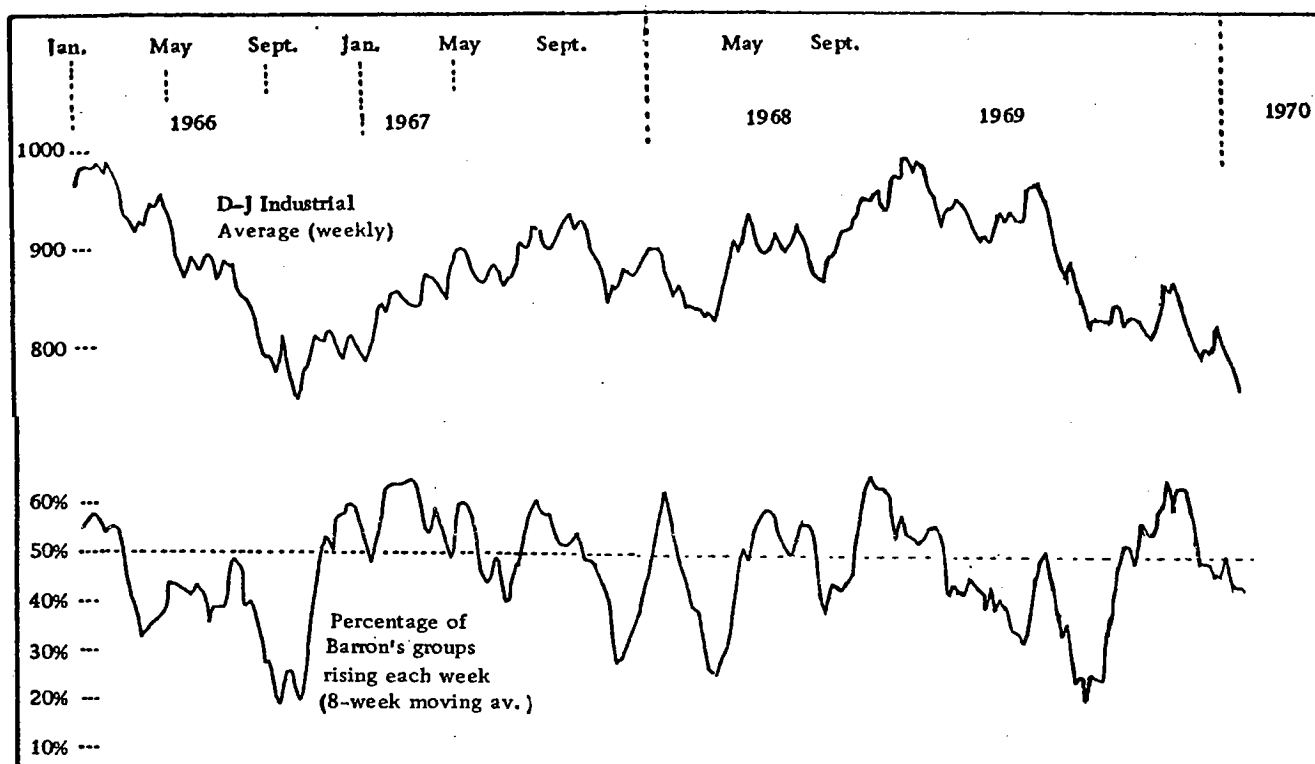
In the stock market, another strange phenomenon has appeared. The odd-lotters simply do not take this decline seriously. For instance, not only have they tended to stay on the buy side as this market declined, but on Friday (January 30) odd-lotters stepped up their buying to the heaviest rate in a month. January 30, by the way, was the day that the Dow closed under its 1966 low!

Odd-lot short sales are even stranger, (and more bearish by my studies). With the market dropping heavily for over a year, odd-lot short sales are running 75% under comparable figures at the 1962 and 1966 bottoms. I just spoke to Garfield Drew in Boston, and he was kind enough to give me the latest monthly tabulation on his famous monthly odd-lot short sales index. The figure is so low it's absurd (I'll present a study in the next Letter). To put it bluntly, the odd-lot shorting crowd acts as if a major advance is coming "tomorrow". I might add that no group generally proves so wrong at the turn. At the actual bottom of this cave-in, I would expect a few days with daily odd-lot shorts of 40 to 50 thousand sales. We're nowhere near that now.

So I say, let's stay out of this market. It's a primary bear market, and that fact alone should be enough to keep most of my studious or serious subscribers in a liquid position. I know that I must have a certain percentage of readers who don't care about Dow's Theory or any other proven investment tool. These are the "in-and-out scalpers," and their only impetus is greed. So I'll say to you too, if you have no investment policy but greed, I don't even have enough near-term evidence to tell you to be greedy now.

**GROUPS ADVANCING:** I am hereby updating a study which last appeared in November, 1967 (Letter 374). Each week I count the number of stock groups (listed in Barron's Laboratory page) which have advanced during the week. I divide the total number of advancing groups by 35 (total of all Barron's groups), and this gives me the percentage of groups which advanced each week. These weekly figures are then arranged in the form of an 8-week moving average. This 8-week index of advancing groups is shown on the Page 3 chart together with the weekly close of the D-J Industrial Average.

Obviously, the critical level for the index is 50%. When, over an eight week average, half or more of the groups are advancing, it means that the market is showing strength. It is perhaps significant that during this primary bear market (which started in February, 1966) the highest the bullish percentage index has been able to rise is to 67%, while twice during the period the index has fallen as low as 20%. In other words, the peaks have not been particularly impressive while the valleys are on the low side.



Note that the three "bottoms" of October, 1966, March, 1968 and July, 1969, have all been associated with figures of 25% or less on the index. In fact, during October, 1966 and again during July, 1969, the index sank to the 20% level. Thus, we might call the lower 20% level the "oversold" territory as far as this bear market is concerned.

Personally, I feel it is very dangerous to attempt to call bottoms during a primary bear market which has gathered a head of steam, as this one has. Nevertheless, we can apply some gauges in an attempt to identify a possible "exhaustion zone" on the downside. As of the last reading, the 8-week moving average of advancing groups stood at 43%. Based on the history of the current primary bear market since 1966, 43% on the index has not identified an oversold situation—nor is it calling for a bottom.

**ENTER THE BEAR:** Robert Rhea often commented that the primary trend was a law unto itself. What he meant by this is that neither the duration nor the extent of a true primary movement can be predicted in advance. A primary bull market advances until the forces of optimism and expansion are fully expressed. A primary bear market declines until all the bearish forces of pessimism and contraction are fully expressed in the price structure.

History shows that there have been bear markets which have wiped out part, most or more than all the gains of the preceding bull market. For instance, the 1929 to 1932 bear market terminated 20 points below the 1921 low (the bull market began in 1921). Again, the bear market which followed the five-year bull market of 1932-1937 lasted another five years, or as long as the preceding bull market.

A few further observations should be made. Bull markets bear little or no relationship to the bear market which precede them. However, bear markets do seem to bear a relationship to the preceding bull market. Since we are now in a major primary bear market, the relationship between a bear market and its preceding bull market should be examined. The majority of bear markets have lasted from 1/3 to 1/2 as long as the preceding bull market. The majority of bear market have wiped out 1/2 or more of all the gains established during the preceding bull market.

I have included a chart on Page 4 (monthly high-low) of the D-J Industrial and Rail Average from 1949 (when the bull market began) to the present. (Chart from M.C. Horsey). The bull market which began in 1949 ended in February, 1966, a period of 17 years. Applying the 1/3 to 1/2 observation, we might expect the current bear market to have a total life span of around five to seven years. Next month will be the fourth year of the bear market. This means that we might expect the ultimate bear market bottom to appear somewhere between 1971 and 1974. My own guess (perhaps it is merely a wish) is that the bear market will end nearer to 1971 than 1974.

As to extent, it should be remembered that the 1949-1966 bull market

advanced a total distance of 834 Dow Industrial points (from 161.60 to 995.15). If the current bear market were ultimately to erase exactly half the gains of the preceding bull market, the Dow would decline to 578. This would be "par for the course," based on the majority of other bear markets. However, a few factors bother me about 578 as a possible terminus point for this bear market. First, the preceding bull market was one of the most speculative in Wall Street annals. Second, since it lasted longer than any other bull market, more excesses were built into the economy and the market. Third, the speculative excesses (in both the market and the economy) continued for four years (until the present) after the bull market top of February, 1966. Finally, during those four years, as seen on the chart, the market formed what might be considered the greatest "top formation" in history.

All of these factors could lead to an extended and drastic bear market, a bear market which might go deeper and much longer than would have been the case if, for instance, the Averages had not stopped and held for over three years after the October, 1966 bottom.

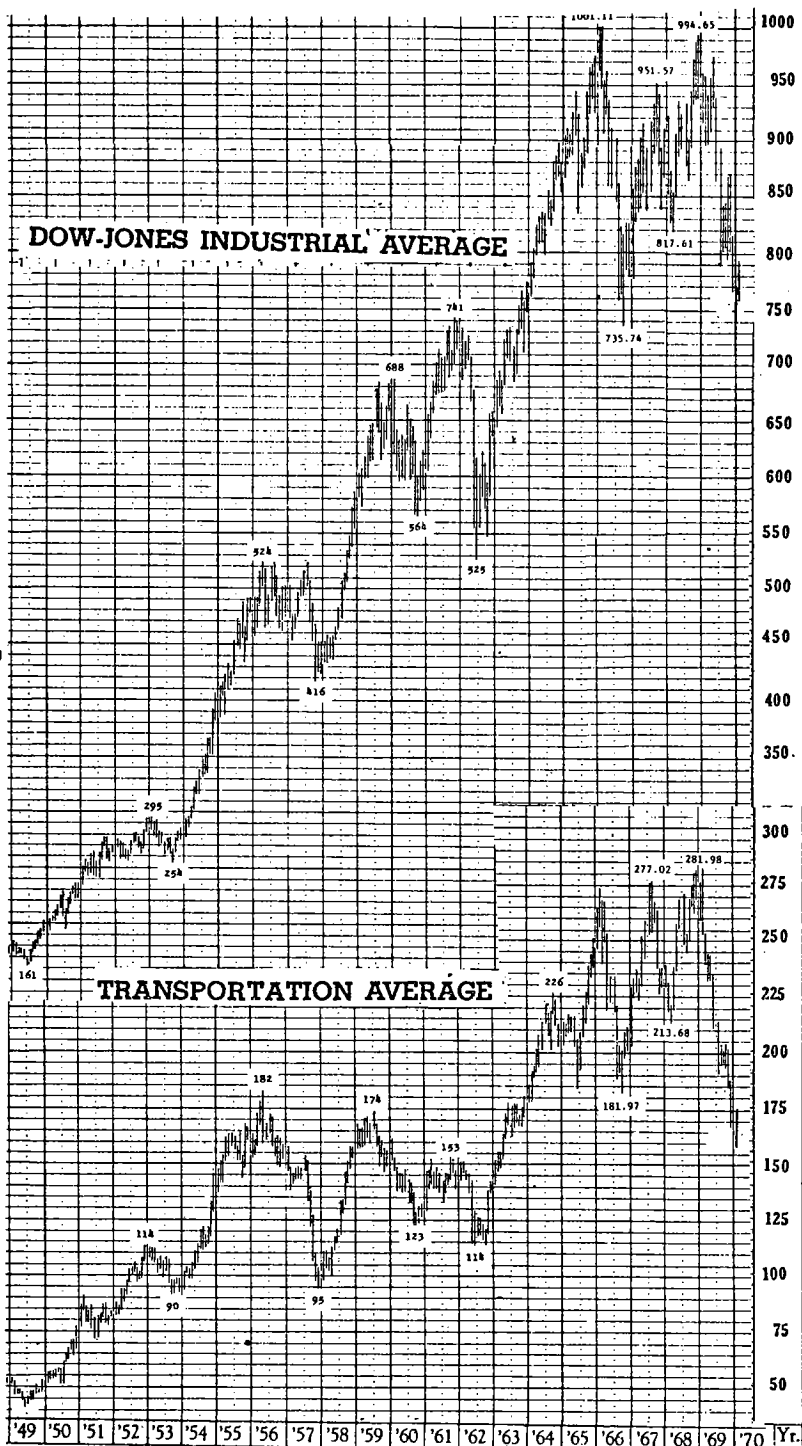
Another observation which I have mentioned before is the intensity and duration of the upward correction which began in October, 1966 and lasted to December, 1968. I have felt all along that this explosive rally, which ran counter to the primary trend, was "using up" much of the rallying or recovery power which might normally be spread throughout the entire bear market. In other words, I feel that the massive upward movement of 1966-69 was "borrowing" from future recovery movements and was therefore very bearish for the long pull.

That thesis could now be in the process of being put to the test. As seen on the chart, the first phase decline of the bear market lasted eight months (February to October, 1966) during which time the Dow declined a total of 251 points. The current second phase decline started in December, 1968 and has now lasted 13 months. As of this writing, the decline has erased 235 points from the Dow. There have been few impressive rallies during the 1969-70 decline, a decline which has now lasted five months longer than the 1966 retreat.

It would not surprise me to see the current sell-off last at least twice as long as the 1966 decline. Furthermore, it would not surprise me to see this second phase decline extend almost twice as far as the 1966 decline. If the current downward movement carries twice as far and lasts twice as long as the 1966 affair, it could carry to mid-1970 or longer, and take the Dow down to the 500 level.

I want subscribers to understand that the above merely represents "guesses," not predictions. The very best observation to follow is still the original one with which I began this section: "primary movements are a law unto themselves." They can go as long as they want and as far as they want.

**GOLD:** I have just finished (belatedly) William F. Rickenbacker's book, "The Death of the Dollar" (Arlington House, New Rochelle, N. Y.). The book is excellent, and it provides a broad picture of the current monetary predicament together with many fine and informative chapters on gold.



It is almost a hopeless task attempting to place the gold picture in context in a stock market Letter of this size. However, a few salient facts might be in order. Gold is the only true international money. It has been treasured by man for 5,000 years. Gold is the only form of money which cannot be degraded by the state. As Rickenbacker points out, gold is the refuge of the citizen who mistrusts the state. If you are a citizen of a nation which is going communist or fascist, you can make your escape with gold. Dictatorships hate gold, since gold represents a greater power than the state. It was against the law to hold gold in Nazi Germany. Yet the Nazis dug the gold out of the teeth of dead concentration camp victims, since even in their dark insanity, the Nazis were well aware of gold's value.

Today the U.S. professes to want to get rid of gold. Yet only weeks ago the U.S. purchased half a billion dollars of gold from West Germany. If the U.S. does not value gold, why is it buying it? The answer is obvious. The U.S.'s dreams of "getting rid" of gold are simply that—dreams. Reality, however, dictates that the U.S. try to build up its now pitifully small gold reserves.

On December 30, 1969, the I.M.F. "reaffirmed" gold's position in a rather strange way. The two major points of the I.M.F. agreement concerned "old gold," or gold mined before March, 1968, and "new gold" or gold mined thereafter. Old gold has a ceiling of \$35 per ounce, and South Africa is not to sell more than \$35 million of this gold in any calendar quarter. New gold can be sold to the I.M.F. any time the price is \$35 per ounce or less—at the rate of \$4 million per day. The I.M.F. is required to buy at \$35 or below, and this in effect puts a floor under gold.

Thus the U.S. was forced to sign the I.M.F. agreement without even extended debate, and this of course means that the U.S. is now a partner in an agreement to place a floor under the yellow metal. If the U.S. indeed views gold as a "barbaric relic," one wonders why it has agreed to be a partner in a plan to guarantee a floor-value for gold. The answer is obvious: The U.S. had no choice at all. Europeans could have easily called in part or all of the \$35 billion which we owe them, and set off a gold panic which would have run the price of gold through the roof.

One of the more pathetic recent innovations was the creation of S.D.R.'s, the much touted "paper gold." These Special Drawing Rights are nothing more than additional quantities of international credit, but the credit is against gold. The S.D.R.'s are not "paper gold," as they have been hopefully termed, they are additional paper credits against gold. The issuance of S.D.R.'s merely means that the world stock of gold is being asked to do more in the way of credit. And of course, that's been one of the main problems all along, the problem being that at the current 1934 price for gold, the dollar is overvalued. A dollar is defined in value as worth 1/35 of an ounce of gold. But with the huge inflated mass of dollars outstanding today, the dollar is actually worth far less than 1/35 of an ounce of gold. Or to put it in reverse, an ounce of gold is worth far more than \$35 dollars.

Sooner or later the true value of gold will come out. Ultimately the fantastic manipulations of those who want to hold down the value of gold must fail. Ask yourself this simple question: if gold is only worth \$35 an ounce, why is it against the law for U.S. citizens to hold gold? The answer is obvious. If you and I were allowed to hold gold we would start buying it, knowing that it was far too cheap at its current price. If gold were set free on the market, it would start moving up in price as we hedged against the dollar by buying it. Our hedging would set off a gold rush and collapse the dollar. The U.S. Government is deathly afraid of the true value of gold. If they weren't, they would allow us to buy and sell it—instead of manipulating the price to their own interest.

Let's look at gold from another standpoint, its unique properties. Gold is one of the most beautiful of the elements and one of the heaviest. It is the only metal which is yellow in its natural state. Gold does not tarnish or rust; it always retains its beauty. Gold is the most ductile and malleable of metals; one ounce can be drawn into a continuous wire 35 miles long, or an ounce can be beaten into a film covering 100 square feet. Gold can be formed into sheets 1/250,000 of an inch thick. Gold can be easily stored. A cubic foot of gold would weigh over half a ton and at today's value be worth about \$600,000. All the gold ever mined in history (\$85 billion worth) would make a single nugget about the size of a small barn.

The commercial uses of gold are now expanding at a rate of about 11.9% per year. By 1975 it is expected that the commercial demand for gold will catch up with production. U.S. domestic demand for gold is now four times U.S. production.

Thus gold has a growth use during good times, whereas in bad times the cost of mining gold decreases and gold mining profits rise. In periods of international chaos gold becomes an "escape" treasure-metal, and a true measure of wealth, in times of monetary chaos gold becomes the only true money.

Page 6      The price of gold topped out in January, 1969, and since then it has returned to \$35 an ounce or slightly under. With the highest interest rates in history, margin calls went out to gold holders all over the world, and the price of the metal was hammered down. It is probable that we have reached the period where the gold speculators have been driven out of the metal and out of the gold stocks.

| THE MINES<br>•ADR QUOTED | QUOTE<br>MID-NOV<br>1969 | CURRENT<br>ESTIMATES |       | ESTIMATES CURRENTLY IN USE |                            |                     | RELATIVE<br>LEVERAGE<br>TO \$70 |
|--------------------------|--------------------------|----------------------|-------|----------------------------|----------------------------|---------------------|---------------------------------|
|                          |                          | P/E                  | YLD   | EARN/SH<br>@ \$70          | VALUE-ACTION<br>MULTIPLIER | VALUE/SH<br>AT \$70 |                                 |
| •Blyvooruitz             | \$ 3.25                  | 6.6                  | 10.4% | \$1.00                     | x 8.0 =                    | \$ 8.00             | 146% *                          |
| •Bracken Mines           | 1.50                     | 5.4                  | 18.7  | 0.70                       | 6.0                        | 4.20                | 180                             |
| •Buffelsfont             | 8.75                     | 5.9                  | 5.9   | 3.00                       | 9.5                        | 28.50               | 229 *                           |
| •Doornfontein            | 3.75                     | 5.9                  | 8.5   | 1.60                       | 9.0                        | 14.40               | 285                             |
| •Durban Deep             | 2.25                     | 4.7                  | 9.3   | 2.60                       | 5.0                        | 13.00               | 478                             |
| •E. Rand Prop.           | 2.25                     | 2.8                  | 3.1   | 2.30                       | 5.0                        | 11.50               | 412                             |
| •Free State G.           | 14.00                    | 6.1                  | 14.0  | 4.20                       | 7.0                        | 29.40               | 110                             |
| •Harmony Gold            | 2.00                     | 4.8                  | 13.0  | 1.30                       | 6.0                        | 7.80                | 290 *                           |
| •Hartebeesfont           | 3.00                     | 5.1                  | 4.7   | 2.00                       | 8.5                        | 17.00               | 468 *                           |
| •Kinross                 | 1.75                     | 3.9                  | 8.0   | 0.75                       | 8.5                        | 6.40                | 266                             |
| •Kloof                   | 4.00                     | 8.9                  | -     | 1.15                       | 10.5                       | 12.10               | 203                             |
| •Libanon                 | 3.50                     | 6.4                  | 10.0  | 1.20                       | 7.5                        | 9.00                | 157                             |
| •Lorraine                | 0.65                     | 6.5                  | -     | 0.55                       | 7.0                        | 3.85                | 492                             |
| •Pres. Brand             | 12.75                    | 7.7                  | 12.6  | 2.80                       | 8.0                        | 22.40               | 76 *                            |
| •Pres. Steyn             | 3.75                     | 5.7                  | 5.6   | 1.40                       | 10.0                       | 14.00               | 274 *                           |
| •St. Helena              | 8.75                     | 6.3                  | 10.8  | 2.60                       | 8.0                        | 20.80               | 138                             |
| •Stilfontein             | 1.00                     | 4.4                  | 9.0   | 0.85                       | 6.5                        | 5.50                | 450 *                           |
| •Vaal Reefs              | 12.75                    | 5.7                  | 5.5   | 3.40                       | 10.5                       | 35.60               | 180 *                           |
| •Welkom                  | 2.25                     | 5.9                  | 12.4  | 1.00                       | 7.5                        | 7.50                | 234 *                           |
| •W. Driefont             | 14.50                    | 9.7                  | 7.2   | 3.50                       | 11.5                       | 40.30               | 178 *                           |
| •W'stn Areas             | 1.50                     | 6.8                  | 4.7   | 0.75                       | 9.0                        | 6.75                | 350                             |
| •W'stn Deep              | 10.00                    | 5.6                  | 9.0   | 2.60                       | 12.0                       | 31.20               | 212 *                           |
| •W'stn Holding           | 17.75                    | 7.1                  | 12.6  | 5.60                       | 8.0                        | 44.80               | 152                             |
| •Winkelhaak              | 1.75                     | 6.3                  | 8.0   | 1.00                       | 9.0                        | 9.00                | 415                             |
| •Zandpan                 | 1.10                     | 7.9                  | -     | 0.65                       | 8.5                        | 5.50                | 400 *                           |

VALUE-ACTION MULTIPLIER is used to estimate present value of future earnings discounted at 8%, plus amortization of original investment over the remaining lifetime of company mines. Figure then adjusted to reflect other important factors affecting future profitability.

#### \* Interest in Uranium

I am including a very interesting table prepared by my friend John McFalls (Value-Action Advisory) of 3838 48th Ave., N.E., Seattle, Wash. 98105. The table is rather self explanatory, and it shows various statistics on South African gold shares including estimates of earnings if gold is increased to \$70 per share plus the leverage (final column) or possible percentage in share-price increase if the price of gold is boosted to \$70 a share. In my opinion, from the standpoint of values, most of the South African gold mining shares are now at bargain levels.

In my opinion, gold shares now represent depressed issues which have been battered down to where they represent uncommon values. They are dealing with a product which has a guaranteed "floor" of \$35 per ounce, but an unlimited ceiling.